STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company d/b/a Nicor Gas Company	)	
	)	Docket No. 08-0363
Proposed general increase in rates, and revisions to other terms and conditions of service	)	

Rebuttal Testimony of

ANTHONY R. MCCAIN

Vice President Field Operations
Nicor Gas Company

September 25, 2008

Nicor Gas Ex. 20.0

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I. INTRODUCTION

Q. Please state your name and business address.

A. Anthony R. McCain, Nicor Gas Company ("Nicor Gas" or the "Company"), 1844 Ferry Road, Naperville, Illinois 60563.

Q. Are you the same Anthony R. McCain who submitted direct testimony on behalf of Nicor Gas in this Docket?

A. Yes.

II. PURPOSE OF REBUTTAL TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Illinois Commerce Commission (the "Commission" or "ICC") Staff witnesses Dennis Anderson (Staff Ex. 9.0) and Peter Lazare (Staff Ex. 7.0); and the Illinois Attorney General's Office ("AG") and Citizens Utility Board ("CUB") (collectively "AG/CUB") witnesses Scott Rubin (AG/CUB Ex. 2.0) and David Effron (AG/CUB Ex. 1.0).

III. SUMMARY OF CONCLUSIONS

Q. Please summarize your conclusions.

A. I conclude the following:

- The infrastructure replacement program proposed pursuant to Rider QIP allows Nicor Gas to more effectively manage and eliminate materials within its infrastructure that are deteriorating at a higher rate, such as cast iron main and copper services.

- The test year increase in Mains and Services Expenses, Account 874, for the test year is reasonable and supported by increases in the Company's distribution operations.

IV. REPLACEMENT OF CAST IRON MAIN AND COPPER SERVICES

Q. Have you reviewed the testimony of Staff witness Dennis Anderson?

A. Yes. Mr. Anderson concludes that the Company's request for Rider QIP should be rejected, and states he has "determined that the Company has failed to demonstrate a need to drastically increase its replacement of cast iron main and copper services as it proposes." (Anderson Dir., Staff Ex. 9.0, 3:44-45).

Q. Do you agree with Mr. Anderson's conclusion?

A. No. I disagree with Mr. Anderson's conclusion. Mr. Anderson suggests that the Nicor Gas has not demonstrated "that the performance of its cast iron main and copper services is declining faster than its historic rate." (Anderson Dir., Staff Ex. 9.0, 7:134-35). This statement reflects a fundamental misunderstanding of the issue that the Company seeks to address with its infrastructure replacement program.

Q. Do you agree with Mr. Anderson that the performance of cast iron and copper services is not declining faster than the historic rate?

A. Our position has never been that the performance of cast iron and copper services is declining faster than their historic rate. Our position has been, and continues to be, that the performance of these particular materials continues to decline at a significantly higher rate than the other materials in the remainder of our distribution system.

Q. Do you agree with Mr. Anderson's conclusion that the Company has failed to demonstrate a need for accelerated replacement?

A. No. However, I do agree with some of the logic upon which Mr. Anderson's purports to base his conclusion. For example, Mr. Anderson states "I believe the decision to

accelerate the replacement of cast iron main and copper services should be based on the condition of the facilities and the need for Nicor Gas to continue to operate a safe and reliable natural gas system." (Anderson Dir., Staff Ex. 9.0, 6:101-04). I agree with Mr. Anderson's comment and believe our rationale for accelerating the replacement of these materials over the next ten years follows his logic. As previously stated, the performance of the cast iron system and copper services is declining at much faster rate compared to the rest of the distribution system. The declining performance of these materials negatively impacts the condition of those facilities, which are targeted to be replaced to allow Nicor Gas to continue to operate a safe and reliable system. To follow Mr. Anderson's logic, the proactive acceleration of replacing these materials will allow Nicor Gas to be even more effective at managing this aging and deteriorating infrastructure.

Q. Mr. Anderson presents a template for quantifying benefits in a way that would support the accelerated infrastructure replacement program. (Anderson Dir., Staff Ex. 9.0, 8:141-45). What are your thoughts on the showing that Mr. Anderson suggests should be required before such program can be implemented?

A. Mr. Anderson's suggestions are reasonable. In fact, the Company already has shown what Mr. Anderson suggests is required. Mr. Anderson states that the Company must provide an overall quantification of the program's affect on safety, reliability, efficiency, customer satisfaction, reduced operation and maintenance costs, balanced work load, and lower overall capital costs. (Anderson Dir., Staff Ex. 9.0, 8:141-45). As stated in Mr. Rubin's testimony, the Company has demonstrated a decrease in its leak rate through its analytical approach to managing its infrastructure. (Rubin Dir., AG/CUB Ex. 2.0,

34:757-35:792). The proposed acceleration of the infrastructure replacement program would allow the Company to be even more effective at lowering the leak rate and improving the overall performance of its infrastructure. In terms of efficiency, this program will allow us to become more efficient in a number of areas.

First, the majority of the gas meters on our cast iron systems are located inside customer's homes. This makes it very difficult to obtain readings. As a result of this program, meters will be relocated outside allowing for easier access and, thus, an ability to obtain more frequent actual meter reads, leading to improved customer satisfaction. Second, though 438 miles of cast iron main were in the Company's system as of 2007, cast iron represents only 1.34% of the total distribution system and is now considered a specialty system, requiring distinct training for those charged with maintaining the system. Continued efforts at training and ensuring that our crews possess the appropriate skills to manage such a small portion of distribution system is inefficient. The ability to eliminate cast iron mains will reduce the training required for employees to maintain and operate the distribution system. Third, our leak investigations will become more effective and efficient as we eliminate lower pressure systems. Additionally, our crews will no longer be required to carry the additional tools or equipment needed to operate and maintain the cast iron systems. Finally, we will no longer need the intermittent three year re-inspection intervals for copper services; therefore, all our inspection intervals will be on a five year cycle, which leads to further cost reduction and mitigates the costs associated with compliance. Nicor Gas has quantified the savings associated with the efficiencies described here, and within my direct testimony, and has provided an estimated overall quantification of $6,000 per mile to address both tangible and

intangible benefits associated with accelerated replacement. (McCain Dir., Nicor Gas Ex. 5.0, 9:178-11:230).

Q. Are Mr. Anderson's suggestions a surprise?

A. No. In fact, the Commission has provided similar guidance in its Order in the recent Peoples Gas rate case, Docket No. 07-0241 (consolidated). In that case, the Commission addressed Peoples Gas' Rider ICR, which outlined an accelerated main replacement program. In rejecting the Peoples Gas proposal, the Commission indicated what information Peoples Gas could have provided that would have made Rider ICR "easier to approve." *Peoples Gas*, Docket No. 07-0241 (consol.), Order at 162 (Feb. 5, 2008). Mr. Anderson's suggestions mirror those included in the Commission's Order. Following the Commission's direction, Nicor Gas has shown that its proposed infrastructure replacement program meets the objectives outlined by Mr. Anderson and articulated by the Commission in its Peoples Gas Order.

Q. Have you reviewed the testimony of Staff witness Lazare? What are Mr. Lazare's conclusions?

A. Yes. Mr. Lazare's conclusions are similar to those of Mr. Anderson in that he suggests that the Company has failed to show ratepayer benefits that will result from "system modernization." (Lazare Dir., Staff Ex. 7.0, 20:425-30). Additionally, Mr. Lazare compares the main replacement program being utilized by Peoples Gas to that being proposed by Nicor Gas to support his contention that the Company does not need an acceleration program. (*Id*., 20:415-21:448).

Q. How do you respond to Mr. Lazare's concerns regarding whether Nicor Gas has adequately demonstrated the benefits to Nicor Gas' operation and Nicor Gas' customers?

A. As I have stated above in response to Mr. Anderson, I believe that Nicor Gas has explained the benefits that will inure to both our operations and our customers as a result of the infrastructure replacement program. Further, as stated in the direct testimony of Mr. O'Connor, customers will receive the benefits of a direct and immediate reduction in rates due to estimated lower operating costs through proposed Rider QIP. (O'Connor Dir., Nicor Gas Ex. 12.0, 33:636-34:673). As indicated by Mr. O'Connor, it is impossible to precisely quantify and identify all potential savings associated with an upgraded system. However, to the extent they are greater than the $6,000 per mile proposed in this case, such additional benefits will be passed along to customers in the way of lower operating cost in the next rate case.

Further, referring to the program as a case of "system modernization" does not capture fully the intent of the program. Nicor Gas has always invested in its infrastructure, and it will continue to do so. Our work in replacing mains and services necessarily results in a modernization of the system over time, but the infrastructure replacement program under Rider QIP is intended to achieve something more. The program is intended to allow Nicor Gas to eliminate materials from its system that are deteriorating at a rate significantly greater than the remainder of it system.

Q. How do you respond to Mr. Lazare's comparison of Nicor Gas' replacement program to that of Peoples Gas?

A. Mr. Lazare's comparison is of little use. Not being familiar with Peoples Gas system, I cannot comment on the effectiveness of their program. Each operator must assess their system based on their individual needs and circumstances, and not merely by what others are doing. However, I would note the fact that Peoples Gas requested a rider in their last rate filing implies that, based on their system performance, they also saw value in accelerating the replacement of cast iron at some rate higher than their current replacement rate.

Q. AG/CUB witness Rubin's testimony, presented on behalf of the AG and CUB, also looks to others within the industry to suggest that Nicor Gas' acceleration program is unnecessary. How do you respond?

A. Mr. Rubin's citation to the industry guidelines and his comparison of Nicor Gas to others within its "peer group" is important in that it shows that Nicor Gas is not alone in facing the problems presented by aging materials within its infrastructure. (Rubin Dir., AG/CUB Ex. 2.0, 32:706-33:742). In addition, Mr. Rubin's comparison to others is an unfair representation and does not convey a clear picture. It fails to address the different drivers and characteristics that affect how individual companies operate their systems, such as geographic location, degree days, installation practices, soil conditions, and customer density—to name a few.

Q. What is your response to Mr. Rubin's suggestion that Nicor Gas has effectively implemented a risk management and pipeline optimization program that eliminates the need for Rider QIP?

A. Mr. Rubin is correct that Nicor Gas has managed to effectively address many concerns regarding the deterioration of its mains and services. (Rubin Dir., AG/CUB Ex. 2.0,

35:784-92). However, we believe we can be even more effective and bring long term benefit to current and future customers. The new federal Distribution Integrity Management Rule proposed by Pipeline & Hazardous Materials Safety Administration ("PHMSA") is based on operators knowing their systems and acting accordingly to mitigate failures. In accordance with this direction, Nicor Gas has identified cast iron and copper services materials as being its highest priority for replacement as compared to the remainder of the distribution system. Our efforts over the last five years, as pointed out by Mr. Rubin, support this. However, while our leak rates for cast iron and copper services have been reduced by 60 and 75 percent respectively, Rider QIP, if accepted, will allow the Company to be even more effective at reducing the leak rate. Such results directly support the Company's mission to provide safe and reliable service.

Q. Is Nicor Gas' proposed Rider QIP a "radical and expensive" program, as Mr. Rubin suggests?

A. Mr. O'Connor speaks to this further in his testimony (O'Connor Reb., Nicor Gas Ex. 27.0), but, in my opinion, the program is not radical. In fact, the U.S. Department of Transportation ("US DOT") Office of Pipeline Safety report referenced in Mr. Rubin's testimony, and available from the US DOT website, supports that what we are seeking to accomplish is considered normal. (Rubin Dir., AG/CUB Ex. 2.0, 31:699-705). In the US DOT report, there were 1,411 distribution companies who submitted main and service data to the Office of Pipeline safety in 2007.

Referring to cast iron, only 180 companies out of the 1,411 have any cast iron in their system. The obvious implication is that the other companies have already proactively removed this deteriorating pipe from their system or are newer systems that

never had such materials. Additionally, only 53 of the remaining 180 companies have more than 100 miles of cast iron left in their system. Nicor Gas, one of those 53, reported 438 miles of cast iron mains, which is the 25th highest reported miles of those with cast iron remaining in their systems.

Referring to copper services, the data was very similar. Only 100 of the 1,411 companies reporting have any copper services remaining. Further, only 40 of the remaining 100 companies have more than 1,000 copper services, and only 24 of those companies have more than 10,000 copper services left in their system. Nicor Gas reported having 90,881 copper services, which is the 4th highest reported number of services of those with copper services remaining it its system.

With regard to the whether the proposed rider is expensive, I can only respond by answering that the Company's intent in pursuing the rider is to minimize the cost of removing these materials. The cost of the removal is a timing issue. Our proposal represents a methodology we believe allows the Company to replace these materials as efficiently and cost-effectively as possible. We have discovered through experience that planning and sourcing higher volumes of replacement at one time allows the Company to realize the benefits of economies of scale and to minimize the cost to replacing its infrastructure. Therefore, the proposal to remove 40 miles of cast iron and 9,000 copper services is more cost effective than removing the historical rates of 15 miles of cast iron and 3,500 copper services. Mr. Rubin and other witnesses suggested alternative is to spread this cost over approximately 32 years and incur additional cost driven by labor and commodity increases, while not capturing operating efficiencies earlier.

V. MAINS AND SERVICES EXPENSES

Q. AG/CUB witness Effron states that the Company has failed to identify any particular factors to support a projected $5,156,000 increase in Mains and Services Expenses and, therefore, proposes an O&M reduction of $3,248,000. (Effron Dir., AG/CUB Ex. 1.0, 25:6-26:2). How do you respond?

A. I disagree with Mr. Effron's proposed reduction. The increase in Account 874 Mains and Services Expenses is primarily due to the following reasons:

- Labor cost increases – approximately $1,800,000
- Contractor cost increases – approximately $1,300,000
- A reclassification of costs between Prime Accounts – $1,896,000

In my position as Vice President, Field Operations, I can address the first two reasons. Mr. Gorenz will address the third reason, the reclassification of expenses between accounts, in his rebuttal testimony. (Gorenz Reb., Nicor Gas Ex. 26.0).

Q. **What are the reasons for the labor cost increases included in Account 874?**

A. There are four primary factors associated with Field Operations and System Operations departments, which are leading to the increase in labor costs. These are: (1) $400,000 due to hourly wage increase per the union contract, (2) $478,000 resulting from additional units and man hours due to increased workload (the equivalent of 9 headcount), (3) $624,000 related to filling management vacancies (the equivalent of 5 headcount) and merit increases, (4) $299,000 due to employee job training costs related to environmental compliance and the amount and timing of staff turnover.

Q. What are the reasons for the contractor cost increases included in Account 874?

A. There are two primary factors leading to the increase in contractor costs. First, $1,076,000 is due to locating contractor volume increases of 1% in 2008 and 2% in 2009 based on historical experience and projected construction activity. This is coupled with a 1.4% increase in locating contractor cost per unit based on existing contract provisions and a 15.8% increase in JULIE administrative fees assessed to all members of JULIE's "One Call Center," including Nicor Gas, to fund ongoing operations. Second, $244,000 is due to an increase in leak survey compliance-related contractor costs.

Q. **What are the details behind the reclassification of costs between prime accounts that increases costs charged to Account 874?**

A. As stated above, please refer to Mr. Gorenz' rebuttal testimony for more details on this cost reclassification. (Gorenz Reb., Nicor Gas Ex. 26.0). This is simply a reclassification between accounts with no impact on overall O&M expense.

Q. What would be the consequences if Mr. Effron's proposed budget reductions were approved in this proceeding?

A. Mr. Effron's arbitrary cost-cutting fails to identify one activity that should be eliminated or curtailed, yet the proposed reductions would obviously and necessarily result in some planned activities and programs being adjusted significantly in response to insufficient funding.

VI. CONCLUSION

Q. Does this conclude your direct testimony?

A. Yes.